Supreme Court, U. S.
FILED
APR 25 1980
MICHAEL RODAK, JR., CLERK

APPENDIX

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner

—*v.*—

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITION FILED: DECEMBER 13, 1979
PETITION GRANTED: FEBRUARY 19, 1980

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Petitioner

—*v.*—

INVESTMENT COMPANY INSTITUTE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

INDEX*

	Page
Relevant docket entries	1
Comments on proposed rulemaking, dated September 10, 1971, by Charter New York Corporation	4
Comments on proposed rulemaking, dated September 20, 1971, by First National Boston Corporation	6
Comments on proposed rulemaking, undated, by the United States Department of Justice	9
Comments on proposed rulemaking, dated September 24, 1971, by State Bond and Mortgage Company	17
Comments on proposed rulemaking, dated September 24, 1971, by the American Bankers Association	20
Factual supplement to Investment Company Institute's petitions for rescission of the regulation	23

---

* The opinion, related orders, and judgment of the court of appeals, the orders of the Board of Governors of the Federal Reserve System, and the challenged regulation and interpretive ruling of the Board are reproduced as appendices to the petition for certiorari and are not printed here.

IN THE MATTER OF THE AMENDMENT OF REGULATION Y OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM TO PROVIDE THAT SERVING AS INVESTMENT ADVISER TO A REGISTERED INVESTMENT COMPANY IS CLOSELY RELATED TO BANKING.
(12 C.F.R. § 225.4(a)(5)(ii))

BEFORE THE BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

RELEVANT DOCKET ENTRIES

DATE	DESCRIPTION
Aug. 17, 1971	Notice of proposed rulemaking
Sept. 23, 1971	Investment Company Institute's ("ICI") comments and request for hearing on proposed rule
Oct. 21, 1971	ICI's supplemental comments on proposal
Nov. 12, 1971	Hearing on proposed rule
Nov. 26, 1971	ICI's posthearing memorandum
Jan. 24, 1972	Notice of adoption of final rule and interpretation
Dec. 12, 1973	ICI's petition for reconsideration and rescission of the rule
March 8, 1974	Board's letter denying ICI's petition
March 18, 1977	ICI's second petition for reconsideration and rescission of the rule
Aug. 31, 1977	Board's order denying ICI's petition

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

INVESTMENT COMPANY INSTITUTE, PETITIONER

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, RESPONDENT

RELEVANT DOCKET ENTRIES

DATE	FILINGS—PROCEEDINGS
(O) 9-23-77	4-Petitioner's petition for review of an order of the Board of Governors of the Federal Reserve System
(T) 11-8-77	Certified Index to Record (n-3)
(T) 12-29-77	15-Petitioner's brief (m-29)
(T) 12-29-77	10-Joint Appendix (m-29)
(T) 6-30-78	15-Respondent's brief (m-30)
(T) 7-28-78	15-Petitioner's reply brief (m-28)
(T) 10-18-78	Argued before McGowan and Wilkey, CJs; and Gasch, Oliver J., US District Court Judge for the District of Columbia
(J) 3-30-79	Opinion for the Court filed by Circuit Judge McGowan.
(J) 3-30-79	Judgment by this Court that the Board's regulation and interpretative ruling challenged in this case are hereby vacated, in accordance with the opinion of this Court filed herein this date.
(D) 5-11-79	4-Motion of BankAmerica Corporation, et al. for leave to file brief as amicus curiae (p-11)
(D) 5-11-79	4-Motion of New York Clearing House Association for leave to file brief as amicus curiae (p-11)

DATE	FILINGS—PROCEEDINGS

(E)5-16-79 11-Respondent's petition for rehearing and suggestion for rehearing en banc (m-11)

(E)6-1-79 Per Curiam order, sua sponte, that within 14 days of this order, petitioner shall file a response to the petition for rehearing and/or suggestion for rehearing en banc filed by Board of Governors; McGowan & Wilkey, CJ's and Gasch, US District Court Judge

(T)6-29-79 4-Motion of Securities Industry Association for leave to participate as amicus curiae (m-29)

(T)6-29-79 4-Motion of A.G. Becker Incorporated for leave to participate as amicus curiae (m-29)

(T)6-29-79 11-Petitioner's response to petition for rehearing and suggestion for rehearing en banc (m-29)

(J)7-13-79 Per Curiam order amending opinion filed on 3-30-79.

(C)7-16-79 Per Curiam order, en banc, denying respondent's suggestion for rehearing en banc; CJ Wright; McGowan, Tamm, Leventhal, Robinson, MacKinnon, Robb & Wilkey, CJs

(C)7-16-79 Per Curiam order denying motions of BankAmerica Corporation, et al. and New York Clearing House Assoc. for leave to file memoranda as amici curiae; McGowan & Wilkey, CJs and Gasch, Judge, US District Court for DC (CJ McGowan did not participate)

(C)7-16-79 Per Curiam order, en banc, denying motions of BankAmerica Corp., et al. and New York Clearing House Assoc. for leave to file memoranda as amici curiae; CJ Wright; McGowan, Tamm, Leventhal, Robinson, MacKinnon, Robb & Wilkey, CJs

(C)7-16-79 Per Curiam order denying respondent's petition for rehearing; McGowan and Wilkey, CJs and Gasch, US District Court Judge for DC

(C)7-16-79 Per Curiam order denying motions filed by Securities Industry Assoc and AG Becker, Inc. for leave to participate as amicus curiae; McGowan and Wilkey, CJs and Gasch, US District Judge for DC

CHARTER NEW YORK CORPORATION

Gordon T. Wallis
President

One Wall Street
New York, N.Y. 10005

September 10, 1971

Secretary
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Sir:

In response to the Board of Governors release of August 17, 1971, and your invitation for comments of interested persons, Charter New York Corporation would like to go on record as favoring the proposal of the Federal Reserve Board to amend Regulation Y under the Bank Holding Company Act to include as a banking related activity "serving as an investment adviser to an investment company registered under the Investment Company Act of 1940".

We believe this activity is clearly "closely related to banking", being consistent with the traditional role of banks in advising fiduciary and agency customers in their investment needs.

As proposed, the amendment does not seek to define either the term investment adviser or the range of services which may be provided by a bank holding company acting as an investment adviser. In addition to the adviser's primary function of furnishing a continuous investment program to an investment company, it customarily undertakes to provide ancillary services. These services may include, among others, acting as sponsor of the fund, pricing agent in the determination of the fund's net asset value and other "housekeeping" and management functions and may require the adviser to assume certain expenses otherwise payable by the fund. In order for holding companies to actively compete with non-bank advisers in servicing investment companies and to adequately protect the interests of the funds' investors, it

would be highly desirable if the Federal Reserve Board defined the scope of incidental activities which bank holding companies can perform as an investment adviser to an investment company.

Therefore, we urge the Board of Governors to clarify their proposed regulatory authorization by stating which incidental activities, normally engaged in by investment advisers of investment companies, bank holding companies may perform.

Very truly yours

/s/ Gordon T. Wallis

FIRST NATIONAL BOSTON CORPORATION
100 Federal Street
Boston, Massachusetts 02110

Richard D. Hill
Chairman of the Board

September 20, 1971

Board of Governors
Federal Reserve System
Washington, D.C. 20551

Gentlemen:

On August 17, 1971 the Board of Governors announced a further proposal concerning activities regarded as closely related to banking under the 1970 Amendments to the Bank Holding Company Act. In its August 17 announcement, the Board proposed to include specifically, within the activity of acting as investment or financial advisor, "(ii) serving as investment advisor to an investment company registered under the Investment Company Act of 1940", in addition to the business of "(i) serving as the advisory company for a mortgage or a real estate investment trust", and "(iii) furnishing economic or financial information". In its announcement the Board invited comment prior to September 24, 1971.

We would like to record our own long standing view that the business of furnishing investment advice to an investment company is a traditional fiduciary service which trust departments or member banks could always appropriately offer their trust department customers.

If we are correct in our judgment that the furnishing of investment advice to investment companies is already a recognized fiduciary activity, the question raised by the language of the Board's August 17 proposal is whether a bank subsidiary of a holding company which proposes to engage in such activity either within the bank itself or in an operating subsidiary of the bank is to be governed by the procedures applicable to acquisitions or activities undertaken under Section 4(c)(8) of the Bank Holding Company Act or whether in such case the activity or

acquisition is one in which the bank subsidiary or the bank's operating subsidiary may engage on the basis of Section 4(c)5 of the Bank Holding Company Act. We have in mind specifically the language of Section 222.4 of Regulation Y which became effective July 1, 1971, and in particular the second sentence thereof ". . .A national bank or a subsidiary thereof may acquire or retain shares on the basis of Section 4(c)(5) in accordance with the rules and regulations of the Comptroller of the Currency."

We believe the Board should make it clear that nothing in the language of the proposal is intended to restrict the traditional and acknowledged freedom of a bank (or bank operating subsidiary) to serve as investment adviser to any customer and that nothing here should impede free entry by a bank in this line of business. It would seem that a national bank or registered bank holding company may acquire an investment adviser under § 4(c)(8) and the procedures imposed by Regulation Y. Might it not be appropriate for the Board in its press release dealing with this activity to include an explanation to this effect?

We are also somewhat concerned by the implication that, in including specifically service as an investment advisor to an investment company registered under the Investment Company Act of 1940, the Board may be precluding a holding company affiliate from acting as an investment advisor to an investment company not registered under the Investment Company Act of 1940, such as an offshore fund.

We are, however, thoroughly in agreement with the Board that the activity of serving as an investment advisor to an investment company is pro-competitive and serves the public interest in that it encourages competition by banks and other bank related intermediaries in an area which has not so far significantly enjoyed the

benefit of the investment expertise of bank trust departments.

Sincerely

/s/ Richard D. Hill
RICHARD D. HILL
Chairman

Copy to:

Mr. Lee J. Aubrey, Vice President
Federal Reserve Bank of Boston

BEFORE THE
BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C. 20551

IN THE MATTER OF

PROPOSED AMENDMENT OF SECTION 222.4(a)(5) OF REGULATION Y: SERVING AS INVESTMENT ADVISOR TO AN INVESTMENT COMPANY REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940

COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

RICHARD W. MCLAREN
Assistant Attorney General

BARRY GROSSMAN
DANIEL R. HUNTER
NEIL E. ROBERTS
Attorneys
Department of Justice
Washington, D.C. 20530

BEFORE THE
BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM
Washington, D.C. 20551

IN THE MATTER OF

PROPOSED AMENDMENT OF SECTION 222.4(a)(5) OF REGULATION Y: SERVING AS INVESTMENT ADVISOR TO AN INVESTMENT COMPANY REGISTERED UNDER THE INVESTMENT COMPANY ACT OF 1940

COMMENTS OF THE UNITED STATES DEPARTMENT OF JUSTICE

By order dated August 12, 1971, the Board of Governors of the Federal Reserve system proposed an amendment to Section 222.4(a)(5) of Regulation Y, Bank Holding Companies. This amendment would add a new subparagraph (ii) to subsection (a)(5), thereby including "serving as investment advisor to an investment company registered under the Investment Company Act of 1940" as one of the activities which "have been determined by the Board to be so closely related to banking or managing or controlling banks as to be a proper incident thereto" and so permissible for bank holding company subsidiaries under Section 4(c)(8) of the Bank Holding Company Act, as amended. The Board invited comments by interested parties no later than September 24, 1971.

As the executive agency of the United States charged with responsibility for enforcing the antitrust laws and promoting competition, the Department of Justice is interested in questions raised by the expansion of bank holding companies into financially related nonbanking activities, and hereby submits its comments on the proposed amendment.

DISCUSSION

Entry of bank holding companies into the business of advising investment companies either by *de novo* entry or by the acquisition of small advisory firms might pro-

mote more vigorous competition in the investment advisory industry and thereby have a salutary effect on the public interest. While the business of advising investment companies (investment funds) does not appear to be highly concentrated, competition has not been effective in reducing advisory fees, primarily because of the absence of arm's length bargaining between the funds and their advisors.[1] The added competition which could be interjected into the fund advisory business by bank holding companies, particularly if it were accompanied by true arm's length bargaining between the advisor and the fund, might serve to reduce advisory fees in the industry. Such a result would certainly appear to serve the public interest and thus would be supported by the Department of Justice.

However, in view of the Supreme Court's recent decision in *Investment Company Institute* v. *Camp*, 401 U.S. 617 (1971), we find a serious question as to whether a bank holding company subsidiary may act as advisor to an open-end investment company (mutual fund). In that case, the Court held that Sections 16 and 21 of the Glass-Steagall Act (12 U.S.C. §§ 24, 378) prohibited a bank from "operating"[2] a mutual fund. In so holding, the Court outlined the following hazards which the Glass-Steagall Act was designed to prevent:

(1) The incentive to sell shares of a fund operated by the bank might distort the investment advice of the bank trust department (pp. 633, 636, 638);

(2) The bank might make unwise loans to customers for the purchase of fund shares (pp. 632, 638);

(3) The bank might make unsound loans to companies in which the fund had invested (pp. 631, 637);

---

[1] See Statement of Commissioner Hugh F. Owens of the Securities and Exchange Commission, Hearings before the Senate Committee on Banking and Currency, 91st Cong., 1st Sess., on S.34 and S.296, to amend the Investment Company Act of 1940, (1969), pp. 28-29.

[2] It should be noted that the bank acted both as investment advisor and distributor of the fund shares and bank officers acted as directors of the fund. 401 U.S. at 622-23.

(4) The bank might make unsound loans to the fund itself (p. 638);

(5) Inadequate performance of a fund closely linked with a bank might impair public confidence in the bank (pp. 631, 637); and

(6) The bank might exploit confidential relationships with its commercial customers for the benefit of the fund (p. 638).

The *Investment Company* case was pending before the Supreme Court at the time that Congress enacted the 1970 amendments to the Bank Holding Company Act. There is no evidence in either the language of the 1970 Bank Holding Company Amendments or its legislative history which clearly indicates a Congressional intent to repeal or modify the prohibitions of the Glass-Steagall Act as applicable to bank holding company activity.

The *Investment Company* decision thus raises two related questions with respect to the proposed regulation: (1) whether as a matter of statutory construction of the Glass-Steagall Act bank holding company subsidiaries are prohibited from advising a fund, and (2) whether the hazards outlined in the decision apply to an investment advisor subsidiary of a bank holding company. Obviously, the more apparent the hazards, the more likely a Court will resolve difficult questions of statutory construction in favor of prohibiting the hazardous activity.

The statutory provision governing affiliations between member banks and securities firms is Section 20 of the Glass-Steagall Act (12 U.S.C. § 377) which provides that:

> ". . . no member bank shall be affiliated in any manner described in subsection (b) of section 221a of this title with any corporation, association, business trust or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities."

Section 221a(b)(2) defines an "affiliate" of a bank as an organization:

> "of which control is held, directly or indirectly, through stock ownership or in any other manner, by the shareholders of a member bank."

Thus an investment advisory firm controlled by a bank holding company which controls a member bank is an "affiliate" of the member bank subsidiary of the holding company. Consequently, if the investment advisory subsidiary of a bank holding company (or any other affiliate) "distributed" the fund shares, as is the usual case with mutual fund managers, the bank holding company's member bank subsidiary would be in violation of Section 20, for its "affiliate" would be engaged in the prohibited act of "distribution."

We assume that the Board's proposed regulation is designed to limit a bank holding company's subsidiary to advising an investment company, as distinguished from distributing its stock. Thus the crucial issue is whether an affiliate strictly limited to *advising* a mutual fund "controls" the mutual fund within the meaning of Section 221a(b)(2). If it does, it might be said to control a company "principally" engaged in the "issue" of securities thereby placing its affiliated member bank in violation of Section 20 of the Glass-Steagall Act.[3]

It should be emphasized that an affiliate can be controlled within the meaning of § 221a, "through stock ownership *or in any other manner.*" (emphasis added) Obviously, forms of control other than stock ownership were contemplated by the framers of the Act. While "control" within the meaning of § 221a does not appear to have been defined, the Board has defined "control" in the context of its responsibilities under the Securities

---

[3] The Board has determined that an open-end investment company (mutual fund) is "primarily" engaged in the issuing of securities within the meaning of § 32 of the Banking Act of 1933 (12 U.S.C. 78); 12 C.F.R. 218.101. Although in *Agnew* v. *Board of Governors*, 329 U.S. 441 (1947), the Court intimated that there might be a difference between "principally" and "primarily", the distinction is not readily apparent in the mutual fund context.

Exchange Act as "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by *contract*, or otherwise" (emphasis added), (12 C.F.R. 206.1(f)). As amended in 1970, the Bank Holding Company Act provides that one company controls another if the first company "exercises a controlling influence over the management or policies" of the other company (12 U.S.C. 1841(a)(2)(c)). Finally, "control" within the meaning of the Investment Company Act means "the power to exercise a controlling influence over the management or policies of a company."[4] The ultimate issue would therefore seem to be whether a bank holding company acting as investment advisor to an open end investment fund exercises a controlling influence over the fund's management and policies. If it does, the relationship would appear to be prohibited by the Glass-Steagall Act.

An investment advisor of a mutual fund is defined as a person "who pursuant to contract with [the fund] regularly furnishes advice to [the fund] with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by [the fund]."[5] There are thus two general types of investment advisors: those who furnish advice on investments and those who have the power to determine themselves what investments the fund will make. Since the business of the fund is investing in securities, the person who has controlling influence over the investment decisions would seem to be "managing" the fund within the control test even though he does not manage the distribution of fund shares. If the fund directors delegate the power to determine investments to the advisor, the advisor would seem to be controlling the fund. A more difficult issue arises where the fund retains truly independent management which has the power to reject the recommendations of the advisor. This would be an

---

[4] 15 U.S.C. 80a-2(a)(9).

[5] 15 U.S.C. 80a-2(a)(19).

unusual fund, since most funds are "externally managed", i.e., the advisor not only does investment research but makes the investment decisions. This avoids duplicating management. In the case of the bank holding company affiliate, however, it would seem that a functioning, internal management would be required in order to preclude "control." [6] Rather than merely rubber-stamping the recommendations of the investment advisor, the management would have to exercise true independent judgment. Whether such an arrangement is economically practical is certainly open to question. The existence of two "managements" might significantly raise costs to the fund.

Turning from the Glass-Steagall Act prohibitions to the policy underlying them, we find that some of the dangers outlined by Congress and repeated by the Supreme Court in the *Investment Company* decision would be present to a certain degree as long as a bank holding company has a "salesman's stake" in the fund. If the advisory fee is set, as it usually is, as a specified percentage of the assets managed, the advisor (and its bank affiliate) might have an incentive to push sales of fund shares to increase the fund's assets. Some danger of distorted investment advice and unsound loans to bank customers for the purchase of fund shares might exist under this type of arrangement. Such potential hazards might be lessened if the bank holding company's investment advisory subsidiary were compensated by the investment company on a basis unrelated to the size of the investment company's assets.[7]

---

[6] Interlocking directorates between the fund and the advisor or any of its affiliates would raise a serious question as to the *de facto* independence of the fund's management.

[7] To the extent that an increase in fund assets would aid performance of the fund, *e.g.*, by permitting it to diversify investments, the bank holding company (and its bank affiliates) might have an incentive to push sales of fund shares even where the advisory fee was not based on fund size. This incentive would be based on the realization that the bank holding company's reputation and success in the advisory business will depend on the performance of those funds which it advises. Two other hazards mentioned by the Supreme Court, exploitation of commercial customers for the

CONCLUSION

The Board's proposal may have significant pro-competitive effects. However, before authorizing bank holding companies to engage in advising investment companies, the Board should make sure that the relationship authorized, including compensation arrangements, would not place the holding company's member bank affiliate in violation of the broad prohibitions of the Glass-Steagall Act so recently reaffirmed by the Supreme Court.

Respectfully submitted,

/s/ Richard W. McLaren
RICHARD W. MCLAREN
Assistant Attorney General

/s/ Barry Grossman
BARRY GROSSMAN

/s/ Daniel R. Hunter
DANIEL R. HUNTER

/s/ Neil E. Roberts
NEIL E. ROBERTS
Attorneys
Department of Justice
Washington, D.C. 20530

---

benefit of the fund and unsound loans to companies in which the fund invested, might also exist regardless of the advisory fee arrangement since the advisor would have a continued interest in the performance of the fund. However, such potential hazards would seem to be no greater than these which exist in any situation in which a bank provides investment advice.

STATE BOND AND MORTGAGE COMPANY

[SEAL]

28 North Minnesota Street
New Ulm, Minnesota 56073
(507) 354-2144

September 24, 1971

Board of Governors
Federal Reserve System
Washington, D.C. 20549

Re: Proposed Amendment to Regulation 222 to Allow Bank Holding Companies to Engage in the Business of Acting as an Investment Advisor to Mutual Funds

Gentlemen:

State Bond and Mortgage Company, 23 North Minnesota, New Ulm, Minnesota, is a bank holding company by virtue of the provisions of the 1970 Amendment. It is alsc an investment advisor to three mutual funds, and we support the proposed amendment to Regulation 222. As we all know, the comptroller of the currency approved of national banks operating "mutual funds" under the auspices of collective agency accounts. While the Supreme Court held that this was not a proper activity for a national bank, it should be noted that the Court based its decision on the language in Section 16 of the 1933 Banking Act which referred to "underwriting, issuing, selling and distributing" securities, rather than a determination in that case that affiliation per se was illegal.

The Court further referred to the hearings on the 1933 Banking Act and recited the evils that the Act was intended to prevent. It cited as main purposes of the 1933 Banking Act, protection of the capital of banking corporations, prevention of unsafe loans, dealings by banks and speculative securities, and possible loss of con-

fidence by the public in banks generally, were banking institutions to recommend certain investments (namely those sold by affiliates).

It was specifically acknowledged by the Court that banking institutions may, and do, engage in purchases and sales of securities through their trust departments. No language in the opinion could be read to limit such authority.

It is obvious, therefore, that the Court placed the greatest emphasis not on the fact of investing as an illegal activity, but rather the promotional nature which may cause certain profits to accrue to the bank at the expense of the banking industry and public as a whole.

Since banks do manage funds and advise clients in trust accounts, such activities must of necessity be closely related to the banking business. The Board of Governors of the Federal Reserve System has previously approved bank holding companies acting as an investment advisor for individuals, again indicating that there is nothing prohibiting investment advisory activities as being closely related to banking.

Since the passage of the Banking Act of 1933, Congress has placed very significant restrictions on mutual funds and other investment companies through the Investment Company Act of 1940, and the amendments thereto. The most recent amendments, of 1970, place upon the investment advisor substantially similar restrictions to those placed upon trusts and trust officers dealing with their trust accounts, i.e. fiduciary responsibility towards the shareholders of the mutual funds. Courts have recently shown an increasing willingness to expand the concept of fiduciary relationship for advisors to a point beyond that of tradition common law concepts using the language of the 1940 Act. See *Moses* v. *Bergin* (First Circuit) decision as amended June 23, 1971 (CCH 93,061), and *Rosenfeld et al.* v. *Black, et al.*, CCA (2nd Cir.) decision June 22, 1971 (CCH 93,093).

There is no present legal prohibition under the Banking Act of 1933 prohibiting investment advisory activities, and banks themselves have engaged in such activities for many years. Investment advisors now have similar fiduci-

ary standards as bank trustees, and when performing similar functions. The Investment Company Act of 1940 regulates all aspects of investment advisory activities in such a manner as to prevent harm from the investment advisor.

Thus, there is no legal or public policy reason for prohibiting bank holding companies from acting as investment advisors to mutual funds, and we would urge the adoption of the proposed amendment to Regulation 222.

Sincerely,

STATE BOND AND MORTGAGE COMPANY

By /s/ Thomas P. Donnelly, Jr.
THOMAS P. DONNELLY, JR.
General Counsel

TPD:dc

cc. Minneapolis Office
Federal Reserve System

[SEAL]

THE AMERICAN BANKERS ASSOCIATION
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Executive Director
Charles R. McNeill
202-467-4087

September 24, 1971

Mr. Tynan Smith
Secretary
Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Dear Mr. Secretary:

In accordance with the notice published in the *Federal Register* on August 25, 1971, by the Board of Governors of the Federal Reserve System, The American Bankers Association is submitting its comments on the Board's proposal to amend Section 222.4(a) of Regulation Y so as to permit a bank holding company to serve as an investment adviser to an investment company.

Our Association concurs with the Board's determination that "serving as investment adviser to an investment company under the Investment Company Act of 1940" is so closely related to banking as to be a proper incident thereto and thus a permissible activity to be engaged in by bank holding companies under Section 4(c)(8) of the Bank Holding Company Act. We therefore support its inclusion in subparagraph (5) of Section 222.4(a) of Regulation Y as proposed by the Board.

The fact that this type of activity is closely related to banking and is consistent with the traditional role of banks in serving fiduciary customers is clearly evidenced. For well over a century, banks and trust companies in every state have managed and administered customers investment funds in the form of trusts, estates and agency accounts. In addition, it is our understanding

that a number of banks are currently providing an advisory service of the kind authorized by the Board for mutual funds.

That the Board's proposal is consistent with Congressional intent and understanding is also readily apparent from the statutory language used in the Investment Advisers Act of 1940. Under Section 202(a)(11) of that Act, the Congress specifically excluded banks and bank holding companies from the definition of "investment adviser" in the context of an investment adviser required to register under the Act. Thus, as a result of the exclusive inference, it is quite clear that the Congress assumed and contemplated that banks and bank holding companies may and do, for compensation, engage in the business of acting as investment advisers.

It is understood that under Section 3(c)(1) of the Investment Company Act of 1940, 15 U.S.C. 80a-3(c)(1), the Securities and Exchange Commission registration and disclosure requirements do not apply to a domestic entity if its outsanding securities are beneficially owned by not more than 100 persons and it does not propose to make a public offering of its securities. Also, it is understood that a foreign company (an offshore fund) can not register under the Investment Company Act of 1940. Apparently, some American banks, either directly, or through affiliates, are engaged in furnishing investment advisory services to such companies. In view of this situation, we question whether the proposed amendment to Regulation Y which is limited to "serving as investment adviser to an investment company under the Investment Company Act of 1940," should not be broadened to include the above companies.

By way of clarification, however, we would urge the Board to make one additional point in the final regulation. As proposed, the Board's amendment does not define either the term "investment adviser" or the range of services which may be provided by a bank holding company acting as an investment adviser. In most instances, in addition to the adviser's primary function of furnishing a continuous investment program to an investment company, it customarily undertakes and is often expected

to provide other ancillary services of a management nature. These services often include purchasing or selling securities or being empowered to determine what securities should be purchased or sold by the investment company, acting as sponsor of the fund, pricing agent in the determination of the funds net asset value and other "housekeeping" functions.

In our judgment, it is imperative that the Board's regulation include both adviser and management functions in order for bank holding companies to actively compete with non-bank advisers in servicing investment companies and to adequately protect the interests of such companies' investors.

The Investment Company Act of 1940 recognizes this and defines an investment adviser as including both advisory and management functions. Accordingly, we would suggest and urge the Board to adopt and apply the definition of "investment adviser" as found in that Act.

In summary, The American Bankers Association supports the Board's proposal to permit bank holding companies to serve as investment advisers and, we would further recommend that the Board clarify or modify its proposed regulatory authorization by adopting the definition of the term "investment adviser" now used in the Investment Company Act of 1940.

Sincerely yours,

/s/ Charles R. McNeill
CHARLES R. MCNEILL
Executive Director
Government Relations

APPENDIX

Factual Supplement

The purpose of this Appendix is to summarize various salient facts concerning the relationships between the 19 investment companies listed in Part I, *supra*, and the bank holding company affiliates associated with them. This summary is based on numerous documents filed by the companies with the Securities and Exchange Commission, all of which are set forth as exhibits to the Affidavit of James W. Jones accompanying this Memorandum.

In its interpretive ruling accompanying the amendment of Regulation Y, the Federal Reserve Board concluded that where a relationship of sponsorship and control exists between a bank holding company (or its affiliates) and an investment company, the entire complex must be viewed as a single entity for Glass-Steagall Act purposes. The facts in the present case clearly demonstrate that such a relationship exists with respect to the 19 investment companies we have examined. Indeed, in the case of seven of the investment companies, the sponsorship of the bank holding company or its affiliate is freely admitted. Thus, Overland Income Securities, Inc. openly states in its SEC registration statement:

> Although Registrant presently has no stock issued or outstanding, Registrant's organization has been sponsored by Wells Fargo Bank, National Association . . . a wholly owned subsidiary of Wells Fargo & Company. [Overland Income Securities, Inc., Registration Statement of Management Investment Company (Form N-8B-1), Item 13.]

Similarly, Vestaur Securities, Inc., explicitly states in its SEC filing:

> Registrant has no shares of its Common Stock presently outstanding. Registrant has been organized under the sponsorship of First Pennsylvania Corporation, the parent of Vestaur Corporation who will act as the investment adviser to the Registrant. [Vestaur Securities, Inc., Registration Statement of

Management Investment Company (Form N-8B-1, Item 13.] [1]

A tacit admission of sponsorship and control can also be found in the fact that in 10 of the 19 cases, the bank holding company affiliates involved have agreed to indemnify the underwriters participating in the distribution of the funds' shares against certain liabilities, including liabilities under the Securities Act of 1933. These ten companies include eight in which sponsorship by a bank or bank-affiliated institution is not openly acknowledged. Moreover, in the case of eight of the funds the indemnification of underwriters has been undertaken directly by the banks themselves rather than by affiliated companies. Typical of these idemnification arrangements is the following provision from the purchase agreement among Peachtree Equity Securities, Inc.; its investment adviser, Citizens and Southern Investment Counseling, Inc.; and its underwriters:

> The Company and the Adviser jointly and severally agree to indemnify and hold harmless each Underwriter and each person, if any, who controls any Underwriter within the meaning of Section 15 of the Securities Act, as follows:
>
> > (i) against any and all loss, liability, claim, damage and expense whatsoever arising out of any untrue statement or alleged untrue statement of a material fact contained in the Registration Statement (or any amendment thereto), or the omission or alleged omission therefrom of a material fact required to be stated therein or necessary to make the statement therein nor misleading or arising out of any untrue statement

---

[1] Similar admissions of sponsorship may be found in the Form N-8B-1 filings of Invesco Income Fund, Inc. and Invesco Equity Fund, Inc. (admitting sponsorship by Citizens and Southern National Bank of Atlanta); Montgomery Street Income Securities, Inc. (admitting sponsorship by BankAmerica Corporation); Current Income Shares, Inc. (admitting sponsorship by Union America, Inc.); and Excelsior Income Shares, Inc. (admitting sponsorship by UST Advisory Company, Inc.).

or alleged untrue statement of a material fact contained in any preliminary prospectus or the Prospectus (or any amendment or supplement thereto) or the omission or alleged omission therefrom of a material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, unless such statements or omission or such alleged statement or omission was made in reliance upon and in conformity with written information furnished to the Company by any Underwriter through you expressly for use in the Registration Statement (or any amendment thereto) or such preliminary prospectus or the Prospectus (or any amendment or supplement thereto);

(ii) against any and all loss, liability, claim, damage and expense whatsoever to the extent of the aggregate amount paid in settlement of any litigation, commenced or threatened, or of any claim whatsoever based upon any such untrue statement or omission, if such settlement is effected with the written consent of the Company or the Adviser, as the case may be; and

(iii) against any and all expense whatsoever reasonably incurred in investigating, preparing or defending against any litigation, commenced or threatened, or any claim whatsoever based upon any such untrue statement or omission, or any such alleged untrue statement or omission, to the extent that any of such expense is not paid under (i) or (ii) above. [Peachtree Equity Securities, Inc., Registration Statement under Securities Act of 1933 (Form S-5), Exhibit G (2).]

Further indication of bank sponsorship and control may be found in the fact that in six cases all organizational expenses of the investment companies, including all costs and expenses arising in connection with the companies' incorporation and their initial registration and qualifica-

tion under applicable federal and state securities laws, are to be borne by the bank holding company affiliate concerned. In two additional cases, such organizational costs will be paid by the banks or bank affiliates only if the initial offerings of the funds' shares are not completed.

Even where sponsorship and control are not readily apparent at the organizational stage, however, there is invariably strong indication that such a relationship exists. Thus, it should be noted that the function of the investment adviser in each of the 19 cases far exceeds the mere rendering of advice. In each instance, the adviser is empowered to manage the investment operations of the company it serves and its portfolio. The adviser not only makes investment decisions for the company, it also places purchase and sale orders for portfolio transactions, usually selects the broker-dealers with whom the company transacts business, and performs a variety of other administrative and management functions. As one investment company put it:

> [T]he Adviser will provide the [Company] with an investment program complying with the investment objectives, policies and restrictions of the [Company] and in carrying out such program, will be responsible for the investment and reinvestment of the [Company's] assets. The Adviser will perform and bear the cost of research, statistical analysis and *continuous complete supervision of the [Company's] investment portfolio.* [Vestaur Securities, Inc., Registration Statement of Management Investment Company (Form N-8B-1), Item 22(c) (emphasis added).]

Typical of the authority conferred on bank or bank-affiliated investment advisers by the investment companies they serve are the following provisions from the Investment Advisory Agreement between Meridian Income Securities, Inc. and The Indiana National Bank:

> The Company hereby retains the Adviser to act as investment adviser to the Company and to supervise and manage the investment activities of the Company as hereinafter set forth. Without limiting the generality of the foregoing, the Adviser shall obtain and

evaluate such information and advice relating to the economy, industries, businesses, securities markets and securities as it deems necessary or useful to discharge its duties hereunder; shall formulate a continuing program for the management of the assets of the Company; shall determine the securities to be purchased, sold or otherwise disposed of by the Company and the timing of such purchases, sales and dispositions; and shall take such further action, including the placing of purchase and sale orders on behalf of the Company as the Adviser shall deem necessary or appropriate for the implementation of such program. The Adviser shall also furnish to or place at the disposal of the Company such of the information, evaluations, analyses and opinions formulated or obtained by the Adviser in the discharge of its duties as the Company may, from time to time, reasonably request.

The Adviser shall, at its own expense, maintain such staff and employ or retain such personnel and consult with such other persons as it shall from time to time determine to be necessary or useful to the performance of its obligations under this Agreement. Without limiting the generality of the foregoing, the staff and personnel of the Adviser shall be deemed to include persons employed or otherwise retained by the Adviser to furnish statistical and other factual data, advice regarding economic factors and trends, information with respect to technical and scientific developments, and such other information, advice and assistance as the Adviser may desire. The Adviser shall, as agent for the Company, maintain the Company's books of account (other than those maintained by the Company's transfer agent, registrar, custodian and other agents). All such books and records so maintained shall be the property of the Company and, upon request therefor, the Adviser shall surrender to the Company any books and records so requested.

* * * *

The Adviser shall bear the cost of rendering the investment management and supervisory services to

> be performed by it under this Agreement, and shall, at its own expense, pay the compensation of the officers and employees of the Company and provide such office space and equipment and such clerical and bookkeeping services as the Company shall reasonably require in the conduct of its business, together with the cost of telephone service, heat, light, power and other utilities. The Adviser agrees to advance registration fees in connection with initial Federal and state registration of Company shares and to assume sole responsibility for such fees unless and until any or all of such shares are sold, and the Company agrees to reimburse the Adviser for amounts so advanced out of the proceeds of the initial public offering of the Company's shares. [Meridian Income Securities, Inc., Registration Statement under the Securities Act of 1933 (Form S-4), Exhibit 5.]

Likewise, the Investment Advisory Agreement between Circle Income Shares, Inc. and American Fletcher National Bank and Trust Company provides, in relevant part, as follows:

> In acting as investment adviser and rendering investment supervisory services to the Company, the Adviser shall obtain and evaluate such information relating to the economy, industries, businesses, securities markets and securities as it may deem necessary or useful in the discharge of its obligations hereunder; shall formulate a continuing program for the management of the assets and resources of the Company in a manner consistent with its investment objectives; shall from time to time make recommendations and furnish advice to the Company regarding securities to be purchased and sold by the Company, and the portion of its assets to be held in cash or cash equivalents, in order to carry out such program; and generally shall take such other steps as the Adviser may deem necessary or appropriate to supervise the implementation by the Company of such program, recommendations and advice. The Ad-

viser shall also furnish to or place at the disposal of the Company such of the information, reports, evaluations, analyses and opinions formulated or obtained by the Adviser in the discharge of its duties hereunder as the Company may, at any time or from time to time, reasonably request or as the Adviser may deem helpful to the Company.

In rendering corporate administrative services to the Company, the Adviser, at its expense, shall:

> (a) Furnish or provide to the Company such official personnel, and such clerical and bookkeeping services (exclusive of and in addition to any such services provided or furnished by any custodian, transfer agent or other institutional agent retained by the Company), as the Company may reasonably require in the conduct of its business, including the maintenance of the Company's accounts and records and the performance of all other functions necessary for the maintenance of its corporate existence and its shareholder relations; and
>
> (b) Furnish the services of individuals competent to perform all executive and administrative functions for the Company, including without limitation such functions related to the execution of portfolio transactions on its behalf as are not assigned to any other institutional agent retained by the Company . . . . [Circle Income Shares, Inc., Registration Statement of Management Investment Company (Form N-8B-1), Exhibit 5.]

Not only are the bank and bank-affiliated advisers responsible for the operation of their investment companies, but in the case of 15 of the funds, the advisers also agree to bear certain excess operating costs incurred by the companies. Typical of these arrangements is the following excerpt from the Management and Investment Advisory Agreement between Montgomery Street Income Securities, Inc. and BA Investment Man-

agement Corporation (a subsidiary of BankAmerica Corporation):

> In the event the expenses of the Fund, including amounts payable to the Manager . . . for any fiscal year ending on a date on which this Agreement is in effect exceed one and one-half percent (1½%) of the first thirty million dollars ($30,000,000) of the average net assets of the Fund, plus one percent (1%) of the average net assets of the Fund in excess of $30,000,000 . . . the Manager will pay to the Fund the amount of such excess as soon as is practicable at the end of a fiscal year. [Montgomery Street Income Securities, Inc., Registration Statement of Management Investment Company (Form N-8B-1), Exhibit 5.]

Still another significant indicium of sponsorship and control may be found in the fact that in 17 of the 19 investment companies examined there are interlocking relationships between directors, officers, or employees of the fund and the bank or bank affiliate advising it. Moreover, the number of interlocking relationships in each case is not insignificant. A majority of officers and most employees of the various funds fall in this category, as well as a minority of fund directors.

Also of significance is the fact that in the case of two funds, the investment companies have obtained the right, through licensing agreements, to use the logos of the banking institutions which "sponsor" them. Likewise, in two additional cases, the name of the investment company itself is technically the property of the bank holding company complex associated with it. Further, 12 of the funds use their "sponsoring" banking institutions as custodians of the funds' portfolio securities or as transfer agents for the funds' own securities.

In each case, of course, the investment adviser is compensated for its services. Although the rates vary somewhat, the usual advisory fee is ½ of 1 percent of the fund's net asset value, computed periodically (typically on a monthly basis). This procedure, of course, ties the advisory fee indirectly to the fund's performance. How-

ever, in the case of at least one fund, Peachtree Equity Securities, Inc., this relationship is made even more explicit. Peachtree has adopted an elaborate fee computation system under which the base fee payable to its adviser may be increased or decreased in accordance with the performance of Peachtree's portfolio securities relative to the Standard & Poor's Index of 425 Stocks.

Based on the foregoing, it is clear, as a factual matter, that the 19 investment companies listed in Part I of this Memorandum are—at least at present—"arms" of the banking institutions associated with them in all but a strictly technical sense. Likewise, there is a clear pattern of close-knit management and supervision which compels the conclusion, in virtually every case, that the bank or bank-affiliated adviser, in effect, "controls" the fund which it serves.[2] Given these facts, it must be concluded —consistent with the Federal Reserve Board's own ruling —that each of the bank holding companies, its banking and nonbanking subsidiaries, and the investment companies associated with it, must all be regarded as a single entity for Glass-Steagall Act purposes.

---

[2] It should be noted that this expansive concept of "control" is not foreign to the banking laws. For example, Section 2(b) of the Glass-Steagall Act, 12 U.S.C. § 221a(b), defines an "affiliate" of a Federal Reserve member bank as any corporation, business trust, association, or other similar organization with respect to which control is held "directly or indirectly, through stock ownership *or in any other manner*, by the shareholders of a member bank . . . ." (Emphasis added.) Similarly, the Federal Reserve Board, in the context of its responsibilities under the Securities Exchange Act of 1934, has defined the term "control" as meaning "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by *contract*, or otherwise" (emphasis added). 12 C.F.R. § 206.2(f). Likewise, the 1970 Amendments to the Bank Holding Company Act provide that one company controls another if it "exercises a controlling influence over [its] management or policies." 12 U.S.C. § 1841(a)(2)(C). Finally, "control" within the meaning of the Investment Company Act of 1940 is defined as "the power to exercise a controlling influence over the management or policies of a company . . . ." 15 U.S.C. § 80a-2(a)(9).

SUPREME COURT OF THE UNITED STATES

No. 79-927

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, PETITIONER,

v.

INVESTMENT COMPANY INSTITUTE

ORDER ALLOWING CERTIORARI

Filed February 19, 1980

The petition herein for a writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit is granted.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1980 316763 272